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IN THE

Supreme Court of the United States

No.

OCTOBER TERM, 1973

CENTRAL TABLET MANUFACTURING CO.,
Petitioner,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI

**To The United States Court of Appeals
For the Sixth Circuit**

The Central Tablet Manufacturing Co., Petitioner, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion and order of the District Court for the Southern District of Ohio (Appendix A, *infra*, p. 11) is reported at 338 F. Supp. 1134. The opinion of the Court of Appeals for the Sixth Circuit (Appendix B, *infra*, p. 22) is reported at 73-2 USTC, ¶9545.

JURISDICTION

The judgment of the Court of Appeals was entered on July 12, 1973 (Appendix C, *infra*, p. 31). The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

The question presented is whether proceeds from disputed fire insurance claims accepted and paid by insurers to taxpayer after adoption by taxpayer of a plan of complete liquidation are entitled to the application of the nonrecognition of gain or loss provisions of Section 337 (a) of the Internal Revenue Code of 1954, where the fire giving rise to the insurance claims occurred before adoption of the plan of liquidation.

STATUTE WHICH CASE INVOLVES

Internal Revenue Code of 1954 (26 U.S.C. §337):

§337 Gain or loss on sales or exchanges in connection with certain liquidations.

(a) General rule.—if—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

STATEMENT OF THE CASE

Taxpayer was an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items in Columbus, Ohio. On September 10, 1965, an accidental fire largely destroyed its equipment, machinery and buildings. The buildings of taxpayer were never rebuilt or repaired and the manu-

facturing equipment was never replaced or repaired following the fire.

At the time of the fire taxpayer carried fire and extended coverage insurance on its buildings and machinery, and business interruption insurance. Negotiations of taxpayer's claim for business interruption loss began on approximately October 8, 1965. Negotiations of the claims for building and equipment and personal property losses began on approximately November 1, 1965. Disputes arose regarding the applicability of a co-insurance clause contained in the building insurance policy, the extent of building loss, the value of the building at the time of loss, the value of the machinery and equipment that was lost or damaged, and the cost of repair of repairable machinery and equipment. On May 14, 1966, the shareholders of taxpayer adopted a plan of dissolution and complete liquidation. On approximately May 20, 1966, taxpayer accepted a settlement of its building insurance claim which was paid to it on or about June 15, 1966. On approximately August 25, 1966, taxpayer accepted a settlement of its personal property insurance claim, which was paid to it on or about November 17, 1966.

On May 3, 1967, all remaining assets after liquidating distributions to shareholders were transferred to a national bank as trustee to meet claims against taxpayer and taxpayer was dissolved under Ohio law.

Taxpayer's business interruption loss claim was settled on or about August 25, 1967, and received on or about September 22, 1967.

Claiming the application of Section 337 (a) of the Internal Revenue Code of 1954, taxpayer did not report the gain realized (the difference between the basis of its assets and the amount of insurance received) upon the in-

voluntary conversion of its property as a result of the fire on September 10, 1965. The Commissioner determined that §337 was inapplicable because the fire occurred before adoption of the plan of liquidation and made a deficiency assessment against taxpayer for additional tax as a result of the gain realized from the involuntary conversion.

Taxpayer paid the additional tax and filed a claim for refund which was disallowed. Thereafter, an action was filed in the District Court for the Southern District of Ohio, under 28 U.S.C. §1346 (a), for recovery of the additional tax. The District Court held that the realized gain from this involuntary conversion was within the nonrecognition provisions of §337 and entered judgment for taxpayer. The Government appealed and the Court of Appeals reversed.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Is In Direct Conflict With The Decision Of The Eighth Circuit Court of Appeals In United States v Morton.[1]

In *United States* v *Morton*, it was held that fire insurance proceeds received after adoption of a plan of liquidation from a fire occurring before adoption of the plan constituted a nonrecognizable gain under §337.[2] The *Morton* decision was followed in *Kinney* v *United States*, 73-1 USTC, ¶9140 (No. Dist. Cal. 1972).[3] In the instant

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[1] 387 F. 2d 441 (8th Cir. 1968).

[2] The full important of *Morton* is that a "sale or exchange" by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. (387 F. 2d 447, 448)

[3] In *Kinney*, the court reasoned that the involuntary conversion did not occur until the insurer's receipt and acceptance of the proof of loss which postdated the adoption of the liquidation plan.

case, however, the Sixth Circuit Court of Appeals declined, expressly, to follow *Morton* (Appendix p. 26).

In addition to being raised in *Morton* and *Kinney* and in this case, the question of the applicability of §337 to an involuntary conversion brought about by a casualty occurring before adoption of a plan of liquidation is raised in at least three cases pending at the administrative level.[4] Moreover, because of the not uncommon occurrence of the events giving rise to the question and the normally significant tax sums which are in the balance, the question will continue to be litigated until the conflict is resolved by this Court. And certainly, neither the cause of efficient tax administration or the cause of improved judicial function will be served by permitting the separate development of case law within each of the eleven circuits—particularly, where, as here, a narrow issue of law, alone, is presented. Indeed, it is precisely in this type of situation that duplicative, expensive and needless future litigation can be prevented by timely review by this Court.

In summary, the recurrent nature of the question presented and its importance from the standpoint of both the number of taxpayers affected and the tax amounts involved—as well as the conflict which has been created—are circumstances which ought to impel this Court to a prompt review of the decision below.

2. The Court Below Erred In Holding That For The Purposes Of The Operation Of §337 The Gain From An Involuntary Conversion Of Property By Casualty Occurs At The Time Of The Casualty.

[4] The cases are *Fisher Baking Company* (L-191-A Code 411) pending before the District Director of Internal Revenue Salt Lake City, Utah; *Estate of Max Goldberg* (L-197B Code 430), pending before the District Director of Internal Revenue, Indianapolis, Indiana; *James F. White, Transferee of the Assets of Floyd Dugan Chevrolet, Inc., Toledo, Ohio*, pending before District Director of Internal Revenue, Cleveland, Ohio.

The enactment of §337 followed the decisions by this Court in *Commissioner of Internal Revenue* v *Court Holding Co.*, 334 U.S. 331 (1945)[5] and *United States* v *Cumberland Public Service Co.*, 338 U.S. 451 (1950),[6] and was intended to eliminate formalistic differences in distributions to shareholders in corporate liquidations as the basis for taxing both a corporation and its shareholders or just the shareholders for substantially the same gain producing transaction.

Prior to the decision in *United States* v *Morton, supra*, on the question that is in issue here, it had been held in *Dwight* v *United States*, 328 F. 2d 973 (2nd Cir. 1964) (involuntary conversion by condemnation) and in *Towanda Textiles, Inc.* v *United States*, 180 F. Supp. 373 (Ct. of Cl. 1960) (involuntary conversion by casualty) that an involuntary conversion of property into money was encompassed within the language "sale or exchange" as used in §337.[7] The Internal Revenue Service has acquiesced in this view—Rev. Rul. 64-100.

In the case at bar, the Sixth Circuit of Appeals seemingly[8] accepted the proposition that an involuntary conversion by casualty is to be treated as a "sale or exchange" under §337, but held, contrary to *United States* v *Morton*, that the involuntary conversion occurred at

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[5] Holding the gain from the sale of the single asset of a corporation by its two stockholders following transfer of the asset to them in liquidation was taxable to the corporation.

[6] Holding gains from sales by stockholders of property received in a general liquidation distribution were not taxable to the corporation.

[7] In *Kent Manufacturing Corporation* v *Commissioner*, 288 F. 2d 812 (4th Cir. 1961) it was held that a "sale or exchange" for the purposes of the operation of §392 (§§392 and 337 differ principally with respect to the period to which they are applicable) included involuntary conversions of property by casualty.

[8] While not rejecting outright the rule of the earlier cases and Rev. Rul. 64-100—that an involuntary conversion by casualty constitutes a "sale or exchange" for the purposes of §337—this is largely the end result of holding, in effect, that the conversion and casualty are one and the same.

the time of the casualty—in this case a fire which occurred before adoption of the plan of dissolution.

The majority[9] seems to have been persuaded to its judgment by the nonjuristic Government argument that the holding in *Morton* gives an advantage to a corporate taxpayer whose property is destroyed by casualty by permitting it to decide whether to rebuild or to liquidate[10] (Appendix p. 30). It is submitted, respectfully, that the opinion of the majority shows only a superficial consideration of the question involved and that its judgment is in error.

Admittedly, an involuntary conversion is not literally a sale or exchange. There are, however, features common to all three transactions, such that tests or standards for determining when a sale or exchange occurs for the purpose of the operation of §337 are meaningful in determining when an involuntary conversion occurs. Significantly, Treas. Reg. §1.337-2(a) provides:

> "Provided the other conditions of section 337 are met, sales or exchanges which occur on or after the date on which the plan of complete liquidation is adopted and within the 12-month period thereafter are subject to the provisions of such section. The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances. In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both, shall be disregarded.

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[9] Judge Kent who was on the panel that heard this case died before it was decided and did not participate in the decision.

[10] The argument is not sound even on this basis; a sale, for instance, can be negotiated before a plan of dissolution is adopted and still be entitled to non recognition (Treas. Reg. §1-337-1(a), *infra*).

> Moreover, an executory contract to sell is to be distinguished from a contract of sale. Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional."

This is also the rule under taxing statutes generally. See *Lucas* v *North Texas Lumber Company*, 281 U.S. 11 (1930); *United States Industrial Alcohol Co.* v. *Helvering*, 137 F. 2d 511 (2nd Cir. 1943).

Involuntary conversion by condemnation is held, uniformly, to occur when title passes to the condemnor under applicable state or federal law.[11] *West Street-Erie Boulevard Corporation v United States*, 411 F. 2d 738 (2nd Cir. 1969); *Covered Wagon, Inc.* v *Commissioner*, 369 F. 2d 629 (8th Cir. 1966); *The Mountain Water Co. of La Crescenta* v *Commissioner*, 35 TC 418 (1960).

In both situations the transaction is held to occur, for the purpose of the application of §337, at that point at which the obligations and rights of the parties become unconditional (in a sale when an unconditional contract is entered into by the parties; in a condemnation when title passes to the condemnor). By a parity of reasoning, an involuntary conversion by casualty of insured property cannot have occurred until some right, at least, to insurance proceeds is agreed upon or otherwise established. And certainly this is not, as this Court of Appeals would have it, at the time of the casualty in every case.[12]

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[11] Under some state statutes this may be at the time of the verdict or award. Opinion No. 3068, Opinions of the Attorney General of Ohio, 1962. A summary of state laws on this point is found in 26 Am. Jur 2d, Eminent Domain §131, p. 790.

[12] In the instant case the original proofs of loss were rejected out of hand by the insurance carriers and prolonged argument was waged as to both the extent of coverage under the policies (a dispute existed over the efficacy of a co-insurance clause) and the amount of damage.

In *United States* v *Morton*, the court held:

> "In any sale or exchange something of value is received for the article sold or exchanged. Usually in a sale the consideration is money which is readily and presently available for use by the holder or else comparable property which is of immediate benefit to the holder. The mere conversion of a tangible capital asset into a chose in action against an insurance company for an undetermined amount is not a completed 'sale or exchange'. Collection is predicated upon compliance with policy conditions, which uniformly require a proof of loss and the allowance of a period of time within which the insurance company may make its investigation before suit may properly be instituted. It would thus appear that the 'sale or exchange' by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. There certainly can be no gain to recognize until the amount of the proceeds is determined and made available. Under this reasoning the 'sale or exchange' would not take place in the case at bar until, at least, December 19, 1960 when the offer of the insurers in settlement of the claims resulting from the fire loss was accepted. Therefore, any gain resulting from the collection of the insurance proceeds would be entitled to nonrecognition under §337." (387 F. 2d 447)

In *Kinney* v *United States*, 73-1 USTC, ¶9140, the court concluded, at page 80, 131:

> "* * * The same reasoning [the reasoning of the condemnation cases that upon passage of title an enforceable right to an exact award comes into being] supports the result reached in this case, an involuntary loss case, since no right to proceeds exists prior to the insurer's receipt and acceptance of the proof

of loss, which postdated the adoption of the plan [of dissolution]."

By analogy, the involuntary conversion of property in this case did not occur before determination or agreement as to the extent of coverage under the insurance policies, which occurred after adoption of the plan of dissolution, and the Court of Appeals incorrectly held that the non-recognition of gain provisions of §337 are unavailable to this taxpayer.

CONCLUSION

Unless promptly resolved by this Court, the conflict between the decision of the Court of Appeals in this case and the decision in *United States* v *Morton*, 387 F. 2d 441 (8th Cir. 1968), will produce a multiplicity of administrative proceedings and court cases. For this reason and because of the importance of the tax question involved the petition for a writ of certiorari should be granted.

Respectfully submitted

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October __, 1973

APPENDIX A

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF OHIO EASTERN DIVISION

CENTRAL TABLET MANUFACTURING COMPANY,
Plaintiff

v.

UNITED STATES OF AMERICA,
Defendant

Civil No. 69-116

OPINION AND ORDER

This action, brought pursuant to Title 28 U.S.C. §1346(a)(1) to recover taxes alleged to have been erroneously collected, comes before the Court for final decision on the stipulations of fact, exhibits, and briefs of the parties.

The uncontested facts in this case are as follows: Plaintiff, Central Tablet Manufacturing Company (hereinafter Central Tablet) was for many years prior to May 14, 1966, an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, art materials and related items at its place of business in Columbus, Ohio. On August 13, 1965, a majority of Central Tablet's production and maintenance employees went on strike, thereby reducing production to approximately 5% of normal volume. On September 10, 1965, during the course of this strike, an accidental fire largely destroyed Central Tablet's equipment, machinery and building, none of which was subsequently repaired or replaced.

The strike was never settled and Central Tablet never again engaged in manufacturing.

As of September 10, 1965, the plaintiff carried fire and extended coverage insurance on its buildings, machinery and inventory. It also carried business interruption insurance. The stated dollar limit of liability on the building was $225,000 under three separate policies of $75,000, which were identical except for the insurer. The stated dollar limit of liability on the machinery and inventory was $450,000 under one policy. The stated dollar limit of liability for business interruption was $100,000 under two policies identical except for the insurer.

Negotiation of Central Tablet's claim for business interruption loss began on approximately October 8, 1965. Disputes arose between Central Tablet and its insurers as to the estimated period of loss to be covered by business interruption insurance and as to the probable duration of the strike had there not been a fire, for the purpose of determining the "actual loss sustained" by Central Tablet during the period of loss covered under the insurance policies. No settlement on this claim was negotiated until August 25, 1967, and on or about September 22, 1967, Central Tablet received $67,000 in payment of its loss.

Negotiations of Central Tablet's insurance claims for building, machinery and personal property losses began on approximately November 1, 1965. Dispute arose regarding the applicability of a co-insurance clause contained in the building insurance policy, the extent of building loss, the value of the building at the time of the loss, the value of the machinery and equipment that was lost or damaged and the cost of repair of repairable machinery and equipment. Central Tablet accepted a settlement of its building insurance claim on approxi-

mately May 20, 1966, and on June 15, 1966, received $174,595.05 in payment thereof. On approximately August 25, 1966, Central Tablet accepted a settlement of its personal property claim and on or about November 17, 1966, received $104,609.27 in payment thereof.

On May 14, 1966, before the corporation had settled any of its claims or received any insurance funds, the shareholders of Central Tablet held a special meeting pursuant to notice, elected to dissolve the corporation and adopted a plan of dissolution and complete liquidation. A certified copy of the Resolution of Stockholders and Plan of Dissolution (see Exhibit 4) was filed with the Cincinnati District Director of Internal Revenue on May 25, 1966. On May 3, 1967, all remaining assets, after liquidating distributions to shareholders, were conveyed to the Ohio National Bank of Columbus, Ohio, in trust for the shareholders pending the complete winding-up of the corporation's affairs, including the payment of taxes and the collection of its insurance and other claims.

I

THE APPLICABILITY OF SECTION 337

The primary question presented for decision is whether the plaintiff's gain from the involuntary conversion of its building, machinery and inventory is exempt from taxation by reason of Section 337(a) of the 1954 Internal Revenue Code, 26 U.S.C. §337(a).[1] The District Director,

[1] §337. *Gain or loss on sales or exchanges in connection with certain liquidations*

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

electing not to follow the decision of the Eighth Circuit Court of Appeals in *United States* v. *Morton*, 387 F.2d 441 (1968), concluded that such gain was taxable and assessed deficiencies against plaintiff in the amount of $70,051.30 for its tax year on October 31, 1965, and $11,930.30 for its 1963 tax year.[2] We conclude that the assessments made by the Director were erroneous in part, and we therefore grant partial judgment for the plaintiff.

The primary object of Section 337 of the Internal Revenue Code was remedial. First, the section intended to eliminate double taxation on the same gain, resulting when a corporation decides to liquidate and thereafter distributes its assets to shareholders themselves subject to taxation. See, *Morton* v. *United States, supra; Pridemark, Inc.* v. *C.I.R.*, 345 F.2d 35 (4th Cir. 1965); *West Street-Erie Boulevard Corp.* v. *United States*, 411 F.2d

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[2] Such assessment was based upon the inclusion by the District Director of the following sums received by plaintiff from fire and business interruption insurance:

1. *Taxpayer's 1967 tax year*
   (a) $223,669.00 (the excess of fire insurance proceeds over net book value, plus $4000.00 in legal fees, assigned as a cost of the sale) received after the adoption of a complete plan of liquidation and distribution within a 12-month period following the date of adoption, in accordance with Section 337. This sum was treated by the Director as a long-term capital gain in the year ending October 31, 1965.
   (b) $12,992.00, representing the pro-rata part of $67,000.00 business interruption insurance proceeds which accrued to it in the year ending on October 31, 1967.
   (c) $20,764.00, representing that part of the total proceeds from fire insurance to be treated as ordinary income resulting from depreciation, within the meaning of Section 1245, Internal Revenue Code of 1954. For a discussion of this assessment, see Part II of this opinion, *infra*.
2. *Taxpayer's 1963 Tax Year*
   (a) $54,008.00, representing the pro-rata portion of the $67,000.00 proceeds from business interruption insurance which accrued to plaintiff in its 1966 tax year (resulting in a decrease in plaintiff's operating loss carryback to 1963).
   (b) The disallowance as an expense in the year ending October 31, 1966, of legal fees in the amount of $4000.00, paid by plaintiff during that year for services rendered in the negotiation and adjustment of the insurance losses.

738 (2d Cir. 1969). Second, the section was promulgated to resolve the conflict created by disparate holdings in *Internal Revenue* v. *Court Holding Co.*, 324 U.S. 331 (1944) and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), and to eliminate technical distinctions based upon the form of corporate dissolution created by these cases. See, *United States* v. *Morton, supra*, 367 F.2d at 444. The thrust of Section 337 is thus to create a rule of exemption which is understandable and easy to apply.

Difficulties of application have arisen, however, as a result of the Court of Claims' holding in *Towanda Textiles* v. *United States*, 180 F.Supp. 373 (1930), a case which established the principle that an involuntary conversion of corporate assets by accidental fire constitutes a "sale or exchange" of property, within the meaning and purpose of Section 337(a). The question which has been raised is this: At what point of time, for tax purposes, should such sale or exchange be deemed to take place? At the time of the involuntary conversion itself? At the time the taxpayer receives proceeds from the conversion? Or at the time that the right to receive proceeds becomes fixed and determinable? The Court in *Towanda Textiles* was not faced with this precise question, since in that case both the fire itself and the realization of proceeds from fire insurance occurred after a plan of liquidation had been adopted and within the 12-month period contemplated by the statute.

The precise question was raised and adjudicated in *Morton* v. *United States*, 258 F.Supp. 922 (W.D. Missouri 1961), the Missouri court holding:

> "In order to carry out the clear intent of Congress in enacting §337, that an involuntary conversion *followed by* adoption of a plan of complete liquida-

> tion by a corporation and the completion thereof within 12 months of its adoption, likewise comes within the intent of Congress when it exempted the corporation from liability for a tax on the gain derived from a sale on its property in liquidation."

In a lengthy and well-reasoned opinion, this holding was sustained by a unanimous Court in *United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968). The Court rejected as unpersuasive the Government's argument that conversion by fire is similar for tax purposes to a conversion by condemnation, where, depending on State law, the simple filing of a condemnation proceeding may give rise to a taxable gain to the condemnee. See, e.g., *Covered Wagon, Inc.* v. *Commissioner*, 369 F.2d 629 (8th Cir. 1966); *Wendell* v. *Commissioner*, 326 F.2d 600 (2d Cir. 1964). Unlike condemnation, the Court concluded, where a conclusive, constitutional right to compensation is vested in the condemnee on the date of the taking, a fire:

> "is but the commencement of an involuntary conversion that does not come into fruition until, at least, the amount to be received by way of reimbursement for that loss is decided either by agreement or by court action . . .
>
> "The mere conversion of a tangible capital asset into a chose in action against an insurance company for an undetermined amount is not a completed 'sale or exchange.' Collection is predicated upon compliance with policy conditions, which uniformly require a proof of loss and the allowance of a period of time within which the insurance company may make its investigation before suit may be properly instituted. It would thus appear that the 'sale or exchange' by involuntary conversion is not completed until either the policy proceeds are received, or an enforceable settlement of a determined amount is agreed upon or a court judgment obtained. There certainly can

> be no gain to recognize until the amount of the proceeds is determined and made available. . . . Therefore, any gain resulting from the collection of the insurance proceeds would be entitled to nonrecognition under §337." 387 F.2d at 447, 448.

The Court concludes that the reasoning and conclusions of *Morton* are persuasive. We adhere to its holding.

The Government asserts, however, that *Morton* is distinguishable from the present case, inasmuch as the claimant there was a cash basis taxpayer whereas the plaintiff here utilizes an accrual method of accounting. In addition, the Government has attempted to show, by way of deposition, that the fact of liability was never put in issue by taxpayer's insurance adjusters, although the amount of liability was subject to negotiation. Thus, the argument goes, this taxpayer's right to receive insurance proceeds became fixed before its plan of corporate liquidation was adopted; that is, at the time of the fire, or as soon thereafter as it became apparent that the insurers' basic liability was not to be contested.

On its surface and applied to the facts of this case, this argument lacks plausibility. In general, under the accrual method of accounting, it is the right to receive income, and not the actual receipt thereof which gives rise to taxation. Income is realized by an accrual taxpayer when his right to receive it becomes fixed and its measure does not depend on future events or contingencies, even though the exact amount may not be determined until later. See, *Cappel House Furnishing Co.* v. *United States*, 140 F.Supp. 92 (S.D. Ohio 1956), *aff'd.* 244 F.2d 525 (6th Cir. 1957); *Ohmer Register Co.* v. *Commissioner*, 131 F.2d 682, 686 (6th Cir. 1942). See also, *Continental Tie and Lumber Co.* v. *United States*, 286 U.S. 290 (1932).

In insurance accrual cases, it has been held that the right to proceeds does not become fixed until there is an unqualified recognition of liability by the obligor. See, generally 2 Mertens, Law of Federal Income Taxation, §12.61 (1967 Rev.); *Maryland Shipbuilding and Drydock Co.* v. *United States*, 409 F.2d 1363 (Ct. Cl. 1969). Furthermore, the amount to be received must be susceptible to calculation; i.e., the taxpayer must have on its own books and accounts some data by which he can reasonably estimate the *quantum* of the sum to be received, if it is to give rise to taxable income. See *Continental Tie & Lumber Co., supra*, 286 U.S. at 296; *Cappel House Furnishing Co., supra*, 244 F.2d at 530. As *Cappel House* recognizes, the vice to be prevented is the forestalling or avoidance of taxation through the simple device of delaying computation of income, the right to which has become fixed and which is reasonably estimable. *Id*, at 530.

The facts of the present matter, taken as a whole, distinguished it from *Cappel House, supra*. At no time was an express admission of liability made by taxpayer's insurance adjusters. Indeed, there is some evidence in the record that the insurance companies denied that notice of claim was properly given by plaintiff. And even if it were possible to conclude that liability was at some point impliedly admitted, there is insufficient evidence in the record to determine at what point in time such admission occurred.

Negotiations between plaintiff and agents of the insurance companies took place over an extended period of almost two years. Involved in these negotiations were three separate insurance contracts, at least two of which were exceedingly complex and difficult to apply under

the circumstances of the case. Disputes occurred over such matters as the applicable period of coverage, the projected length of the strike, and the repairability and valuation of damaged machinery. In one instance, with regard to plaintiff's property insurance claim, questions arose as to the applicability of a co-insurance clause, which if found to be applicable, would have reduced plaintiff's coverage by 43%.[3] In each case, substantial discrepancies existed between the initial offers made by the insurance companies, the maximum permissible insurance coverage, and the amounts ultimately negotiated. And, although dollar amounts were finally (and somewhat arbitrarily) agreed upon, the parties were evidently unable to resolve many of their differences in interpreting the scope of coverage.

Under all of the above circumstances, it would be an utter fiction for us to conclude that the taxpayer realized fixed and estimable income before it adopted a plan of liquidation on May 14, 1966. While there are instances in which double taxation may result from the operation of law, it is not the considered policy of this Court to seek out situations in which to impose a double tax. Accordingly, the Court holds that Central Tablet was entitled to Section 337 non-recognition of gains realized from insurance proceeds and is entitled to a refund of taxes thereon which have been erroneously collected.

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[3] It has been held, even where the amount of insurance loss has been fully adjusted, that accrual of insurance proceeds is not required until the insurer has formally waived co-insurance requirement affecting part of the claim. See, e.g., *Georgia Carolina Chemical Co.*, 3 Tax Ct. 1213, 1216 (1944).

II

THE SECTION 1245 INCOME

Pursuant to Section 1245 of the Internal Revenue Code,[4] 26 U.S.C. §1245, the District Director assessed a tax on $20,764.00 of property and building insurance proceeds, representing ordinary income received by taxpayer from the recapture of depreciation. The parties are in agreement that Section 1245 overrides the nonrecognition provisions of Section 337 and have stipulated that the above amount is subject to taxation. The only question presented is whether such proceeds were taxable in plaintiff's 1965 tax year, as assessed by the District Director, or in plaintiff's 1966 tax year, as contended by the plaintiff.

For reasons fully and adequately stated in Part I of this Opinion, the Court holds that plaintiff's gain from the involuntary conversion of Section 1245 property did not accrue until it settled its claim in 1966 and received monies in payment of building and property losses. Accordingly, plaintiff is entitled to a refund of the tax assessed in 1965.

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[4] §1245. *Gain from disposition of certain depreciable property*

(a) General rule.—

(1) Ordinary income.—Except as otherwise provided in this section, if section 1245 property is disposed of during a taxable year beginning after December 31, 1962, the amount by which the lower of—

(A) the recomputed basis of the property, or

(B) (i) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) in the case of any other disposition, the fair market value of such property, exceeds the adjusted basis of such property shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. *Such gain shall be recognized notwithstanding any other provisions of this subtitle.* [emphasis added]

III

LEGAL FEES AS A CAPITAL EXPENDITURE

Central Tablet took as an ordinary income deduction for tax years 1966 and 1967, $4,000.00 for legal fees attributable to negotiations and settlement of the insurance loss. It used its 1966 deduction to increase its operating loss carryback for the 1963 tax year. See note 2, *supra*. The District Director disallowed these deductions, treated them as capital expenditures, and assessed deficiencies against the taxpayer. Since plaintiff now concedes that the District Director's assessment was correct, we find it unnecessary to consider this question. But see, *Lanrao, Inc.* v. *United States*, 288 F.Supp. 464 (E.D. Tenn. 1968), *aff'd. per curiam*, 422 F.2d 481 (6th Cir. 1970).

WHEREFORE, it is the finding of this Court that deficiency assessments entered by the Internal Revenue Service against the plaintiff were erroneous as a matter of law and that plaintiff is entitled to a refund for its 1963 and 1965 tax years. Judgment is hereby entered in plaintiff's behalf for $81,981.60, less an amount representing the tax difference between ordinary income deduction and the capital expenditure deduction on $8,000.00. This latter figure, and the final judgment award, shall be computed by the defendant, approved by the plaintiff, and forwarded to the Court, within twenty (20) days of receipt of this Opinion.

It is so ORDERED.

CARL B. RUBIN
United States District Judge

APPENDIX B

No. 72-1582

UNITED STATES COURT OF APPEALS
For The Sixth Circuit

CENTRAL TABLET MANUFACTURING COMPANY, *Plaintiff-Appellee,* v. UNITED STATES OF AMERICA, *Defendant-Appellant.*	ON APPEAL from the United States District Court for the Southern District of Ohio, Eastern Division.

Decided and Filed July 12, 1973.

Before: McCREE and KENT*, Circuit Judges, and McALLISTER, Senior Circuit Judge.

McCREE, Circuit Judge. Section 337[1] of the Internal Revenue Code of 1954, as amended, has been judicially interpreted to provide for nonrecognition of a capital gain realized by a corporate taxpayer upon receipt of fire insurance proceeds paid after the destruction of property, if both the fire and payment occur within a 12-month period after the adoption of a plan of complete liquidation. This appeal requires us to determine whether the involuntary conversion (which equates with a sale or exchange of the property for purposes of §337) occurs

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* Judge Kent died on May 28, 1973 and did not participate in this decision.

[1] The pertinent portion of §337 is as follows:

§337. Gain or loss on sales or exchanges in connection with certain liquidations

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

when the property is destroyed or when the policy proceeds are received because this taxpayer adopted a plan of complete liquidation after a fire but before receipt of the insurance proceeds. In an action for refund of $81,732.39 in taxes paid under protest, the district court determined that the involuntary conversion did not occur until the insurance proceeds had been paid. We hold that the conversion took place at the time the property was destroyed and reverse the judgment of the district court.

Appellee Central Tablet Manufacturing Company was an Ohio corporation with offices and manufacturing facilities in Columbus, Ohio. Until 1965 it employed a sizable labor force and was a profitable manufacturer of writing tablets, school supplies, art materials, and related articles. An August 13 of that year, taxpayer's production and maintenance employees went on strike. While the strike was in progress, an accidental fire on September 10, 1965, extensively damaged or destroyed the greater part of appellee's equipment, inventory, and building. Taxpayer, at the time of the fire, carried both fire and business interruption insurance, and timely notified the insurance carrier of the loss.

Although the insurance carrier questioned neither the validity of the insurance contracts nor the fulfillment of the conditions for payment thereunder,[2] it did dispute the amount to be paid under each policy.[3] Negotiations between the taxpayer and the insurer began on Novem-

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[2] Mr. James A. Wroe, the insurance adjuster assigned to this case, testified that "it was obvious that there was a fire. It was in progress when I was first on the scene. Now, liability is not a factor there. I mean, the contract provides the coverage for fire, and what remains then, is to establish the extent of damage." He then testified that neither he nor the insurer ever challenged or considered challenging the insurance coverage in this case because there was no sign of arson.

[3] The insurer asserted the applicability of a coinsurance clause in the fire policy on the building, and challenged the company's valuation of the building and machinery at the time of loss and the cost of repair of the few repairable pieces of machinery.

ber 1, 1965, to adjust the payments due under each policy. These efforts culminated in an agreement on the building claim on May 20, 1966 and on the personal property and other claims on August 25 of the same year.[4] However, on May 14, 1966, six days before the first settlement and a full nine months after the fire, the shareholders of Central Tablet voted to dissolve the corporation and to liquidate its assets. Within the succeeding year, all corporate assets were collected, debts were paid, liquidating distributions were made to the shareholders, and, on May 3, 1967, a reserve was deposited in trust for the shareholders in the Ohio National Bank of Columbus, Ohio to await payment of final debts in completion of the liquidation.

As an accrual-basis taxpayer, appellee treated the gain realized from the fire insurance proceeds as nonrecognizable under IRC §337. However, the Commissioner of Internal Revenue determined that the taxpayer had not qualified for this treatment because the shareholder liquidation vote came after the fire, which the Commissioner regarded as the time of conversion and thus of the "sale or exchange" to which §337 refers. The taxpayer paid the deficiency assessed by the Commissioner and initiated a timely refund suit in the district court.

The district court, recognizing that this Circuit had not previously decided when an involuntary conversion occurs for purposes of §337, followed the holding of the Eighth Circuit in *United States* v. *Morton*, 387 F.2d 441 (8th Cir. 1968), and entered judgment in favor of the taxpayer. The Government has appealed.

It is important at the outset to comment upon an uncontested issue. The Government does not now contest

[4] Payment for the building claim was made on June 15, 1966, in the amount of $174, 595.05 and for the personal property claim on November 17, 1966, in the amount of $104,609.27.

the treatment of a fire loss as a "sale or exchange" under §337, although this is contrary to its position prior to 1964. Shortly after the passage of the Internal Revenue Act of 1954, the Commissioner of Internal Revenue, through Rev. Rul. 56-372, flatly stated that a casualty loss was not a sale within the meaning of §337.[5] This position was vigorously and consistently, although unsuccessfully, advocated before the court of claims[6] and the Fourth Circuit.[7] But in 1964, in Rev. Rul. 64-100, the Commissioner finally capitulated to the weight of mounting authority by revoking Rev. Rul. 56-372 and adopting the prevailing judicial view.[8]

The sole issue before us is on what date, for purposes of §337, does the involuntary conversion that equates with the "sale and exchange" occur when insured capital assets are destroyed by fire. For the reasons hereinafter stated, we hold that the date the fire occurs is the date on which the conversion takes place for purposes of determining the applicability of §337. Accordingly, since the appellee failed to adopt a plan of liquidation before the fire occurred, it does not qualify for nonrecognition of the gain from insurance proceeds.

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[5] "Accordingly, it is held that the receipt of fire insurance proceeds from the complete destruction of a building by fire, resulting in an involuntary conversion, does not constitute a 'sale' for the purpose of obtaining nonrecognition of gain or loss benefits where liquidation of corporate assets is made pursuant to section 337(a) of the Internal Revenue Code of 1954." Mertens, *Law of Federal Income Taxation*, 1954-57 Rulings 389 (1958).

[6] *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp 373 (Ct. Cl. 1960).

[7] *Kent Manufacturing Corp.* v. *Commissioner*, 288 F.2d 812 (4th Cir. 1961).

[8] Consistent with the *Towanda Textiles, Inc.* and *Kent Manufacturing Corporation* decisions, conversions of property of the type described in section 337 of the Code will be treated as sales or exchanges for purposes of that section, where such conversions result in loss as well as gain, regardless of whether such property is the type described in section 1231 of the Code and regardless of whether such property has been held for more than six months." Mertens, *Law of Federal Income Taxation*, 1961-65 Rulings 636 (1966).

The taxpayer insists that in this case, the involuntary conversion by fire that equates with a sale or exchange did not occur until the insurance proceeds were finally paid. He relies on *United States* v. *Morton, supra.* The Government, on the other hand, contends that the date of the fire should be regarded as the date of "sale."

We respectfully decline to follow *Morton.* In that case the Eighth Circuit analogized the involuntary conversion to a commercial sale where "the consideration is normally money which is readily and presently available for use by the holder or else comparable property which is of immediate benefit to the holder." 387 F.2d at 447-8. It determined that the "sale" could only be concluded when the taxpayer could specifically quantify the consideration it would receive, either by judgment or agreement. *Id.* However, this view misapprehends the purpose of §337.

The legislative history indicates that §337 was enacted to establish an easy-to-follow and well-defined corporate procedure by which the capital gains realized in liquidation sales would not be taxed to the corporation, but only to the shareholders upon distribution to them of the proceeds as liquidating dividends. In the ten years preceding the adoption of the Internal Revenue Act of 1954, two Supreme Court cases created considerable confusion concerning the way in which a corporation could escape taxation of gains under IRC §22(a) (1939), from the sale of all its assets after a decision to liquidate the business. In *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), the Supreme Court upheld the tax court's determination that the corporation's breaking off negotiations to sell its only asset, an apartment building, and its subsequent conveyance of the building as a liquidating dividend to its sole shareholders, a husband and wife, who later sold it to the same persons with whom the

corporation had been negotiating and reduced the sale price by the $1,000 down payment given to the corporation, "showed a sale by the corporation rather than by the shareholders . . . ." 324 U.S. at 332. Although the court of appeals had reversed the tax court because it drew different inferences from the undisputed facts, Justice Black, in reiterating that findings of the tax court are binding on appellate courts, reasoned that

> [t]he incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. . . . To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress. 324 U.S. at 334.

Five years later in *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), Justice Black, again speaking for the majority, this time upheld a court of claims determination that the corporation's shareholders had properly negotiated the sale of corporate assets distributed to them in kind in a partial liquidation without incurring the corporate tax liability of IRC §22(a).

Although different outcomes resulted, there are many similarities in the two cases. In both *Court Holding* and *Cumberland*, the objective was the same: avoidance of corporate taxation. There was an offer to buy made to each corporation before negotiations with the shareholders commenced. The corporate assets were distributed in kind to the shareholders in both instances. Both sets of

shareholders intended to sell the assets immediately upon receipt. Both sets of shareholders received all the proceeds of the sale.

The only significant difference appears to be that in *Court Holding*, the two shareholders were also the managing officers of the corporation and merely changed hats in negotiating with the same purchaser after the apartment building was deeded to them. In *Cumberland* there were shareholders in addition to those who retained managerial positions, and this fact arguably implies that activities of the managing shareholders during the initial negotiations served broader interests than those of the corporation alone.

But this theoretical difference ignores the practical control that relatively small numbers of shareholders in closely held corporations exercise over corporate decision-making. Such a tenuous difference should not justify denying nonrecognition to one closely held corporation and granting it to another when the shareholders of both corporations have the same motives and exercise the same degree of effective control. These cases illustrate the difficulty of distinguishing between a sale by a corporation and a sale by its shareholders. Nevertheless, as Mr. Justice Black observed in *Cumberland*, the existing statutory scheme made such an inquiry necessary:

> The oddities in tax consequences that emerge from the tax provisions here controlling appear to be inherent in the present tax pattern. For a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet it is not taxed if that property is distributed in kind and is then sold by the shareholders. In both instances the interest of the shareholders in the business has been transferred to the purchaser. . . .
>
> Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation

> may dispose of corporate property, we accept its mandate.

338 U.S. at 455-6.

The Congress, four years later in the course of its revision of the entire tax code that resulted in the Internal Revenue Code of 1954, attempted to remedy this unsatisfactory situation. The House Committee resolved that, since ". . . under present law, the tax consequences arising from sales made in the course of liquidation depend primarily upon the formal manner in which transactions are arranged, . . . [y]our committee intends . . . to provide a definitive rule which will eliminate any uncertainty." 3 U.S. CODE CONG. & ADMIN. NEWS 1954, at 4244. The remedial rule enacted, §337(a), permitted only ". . . the imposition of a single tax at the shareholder level upon property sold during the course of a liquidation irrespective of whether the corporation or the shareholder in fact effected the sale . . . ." *Id.* at 4245. Even prior negotiations have no effect: "Since subsection (a) refers to 'a sale' the fact that negotiations have been commenced prior to sale is immaterial . . . ." *Id.* However, the statute clearly requires, as taxpayer concedes, the adoption of a plan of complete liquidation before the sale or exchange of property occurs. *See* note 1 *supra.*

It is clear, then, that Congress decided to grant nonrecognition treatment only to a corporation that had already decided to cease operations and liquidate. It eliminated the necessity of determining whether a sale of all the corporate assets by shareholders to whom the assets had been distributed as a liquidating dividend was, for tax purposes, a sale by the corporation. The judicial extension of the section to provide for nonrecognition of a gain when the assets are involuntarily converted either by destruction or condemnation was intended to prevent an injustice to shareholders who had adopted

a plan of liquidation but who thereafter lost their property by destruction or eminent domain before it could be sold. *See Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. Cl. 1960). To expand the statute further by construing it to permit nonrecognition when the property is destroyed before adoption of a plan of liquidation would, instead of preventing injustice to a taxpayer that had decided to liquidate, give it an advantage over other taxpayers by permitting it to decide after destruction of the property whether to rebuild with insurance proceeds or to liquidate. The Congress has provided relief for taxpayers who experience casualties and elect to use insurance proceeds to rebuild. Section 1033 provides for nonrecognition of gains from insurance proceeds if they are employed to replace the destroyed property within a stipulated time. We decline to read §337 to give the same relief to taxpayers who decide to retain the insurance proceeds and go out of business. Section 337 is a statute designed to prevent double taxation when a corporation is committed to liquidation, and was not intended to serve as a relief measure for taxpayers who by fortuity suffered a destruction of corporate assets and still realized a gain. We have recently reaffirmed in a case involving another nonrecognition statute the "well settled principle that statutes granting tax exemptions or deferments must be strictly construed," *Elam* v. *Commissioner of Internal Revenue*, No. 72-1836, at 3 (May 22, 1973), and in obedience to that principle we conclude that the sale or exchange experienced by appellee in this case occurred on the date when its property was destroyed.

Reversed and remanded for further proceedings consistent herewith.

APPENDIX C

UNITED STATES COURT OF APPEALS

For The Sixth Circuit

No. 72-1582

CENTRAL TABLET MANUFACTURING CO.,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before: McCREE, and KENT, Circuit Judges, and McALLISTER, Senior Judge.

JUDGMENT

APPEAL from the United States District Court for the Southern District of Ohio

THIS CAUSE came on to be heard on the record from the United States District Court for the Southern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and the case is remanded for further proceedings.

It is further ordered that Defendant-Appellant recover from Plaintiff-Appellee, the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

ENTERED BY ORDER OF THE COURT

Issued as Mandate: August 7, 1973 JAMES A. HIGGINS
COSTS: To be recovered by Appellant *Clerk*
Filing Fee . . . . . $_____ A True Copy.
Printing . . . . . $190.75 Attest:
JAMES A. HIGGINS
Total . . . . . .$190.75 *Clerk*